LATVIJAS REPUBLIKAS FISKĀLĀS DISCIPLĪNAS PADOME

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Fiscal discipline monitoring report recommendations

Key recommendations for the consultation with the Parliamentary Budget and Finance committee

1. The Council recommends a cautious fiscal policy for 2016 and the remainder of 2015 to preclude the possibility of a significant deviation from the general government budget structural balance objective.

2. Carefully assess all sources of fiscal risk, including risks arising from the financial sector and capital calls, because these have had a negative impact on the general government structural balance in the past and require the establishment of an appropriate fiscal security reserve.

3. The new tax policy and administration strategy should clearly outline a plan for reaching the Government objective of a tax-to GDP ratio of 1/3, focusing on the reduction of the shadow economy, improving the efficiency of tax collection, as well as reviewing tax rates and eliminating exemptions.

4. While the Council generally approves the use of MoF's macroeconomic forecast as the basis for drafting the state budget for 2016 and the MTBF for 2016/18, it strongly encourages the MoF to devise contingency measures for improving the budget balance in the realistic event of budget revenues falling short of the estimates.

5. In order to boost medium and long term development, growth-stimulating structural reforms should be implemented, addressing the issues of a decreasing labour force, a rigid investment sector and the mismatch of the economically active population’s skills and abilities with the labour market's requirements.

Full Schedule of Recommendations for discussion with the Ministry of Finance

No	Report Chapter	Recommendation
1	**1 Fiscal Policy Challenges**	The Council recommends a cautious fiscal policy for the remainder of 2015, bearing in mind the likelihood of having to correct the fiscal balance for 0.5% of GDP in case of significant deviations.
2		Reaching a tax-to GDP ratio of 1/3 should be the key objective while developing a tax policy and administration strategy, focusing on the reduction of the shadow economy, improving the efficiency of tax collection, as well as reviewing tax rates and eliminating exemptions.
3		Consider the reduction of income inequality when designing future tax policy; in particular, look at increasing the tax burden on dividends and other capital income not used for reinvestment.
4		Increase budget revenues in a growth friendly manner by fully utilising the potential of property taxes and environmentally related taxes.
5		Consider eliminating skill mismatch by increasing the professional relevance of the skills and qualifications provided by educational establishments to improve the long term productivity of the Latvian labour force.
6		Consider addressing overall health system efficiency and sustainability by optimising the distribution of funding with the objective of improving population health status indicators and decreasing amenable mortality rates.
7	**Fiscal risk assessment and the adequacy of the fiscal stability reserve**	Accept the FRD approved by the Government, while reiterating the need for the FSR and stressing the need to survey all possible sources of fiscal risk.
8		Include risks arising from the financial sector in the FRD since these have been significant in the past. Risks related to possible capital calls from the European Stability Mechanism and their future impact should also be carefully assessed.
9		Improve the quality of risk assessment by collecting information pertaining to all fiscal risks and, if possible, quantify them in order to have a reliable estimate of their potential fiscal impact.
10		Provide a more detailed description of how probabilities are assigned to particular risks to facilitate the review process for independent institutions.
11		Ensure collection and exchange of information to improve risk management and develop procedures to prevent sudden impacts on the fiscal balance.
12	**2 Macroeconomic Outlook and the output gap**	While the Council generally approves the MoF's macroeconomic forecast as a basis for drafting the state budget for 2016 and setting the budget framework for 2017/18, it strongly encourages the MoF – a) to provide a more profound sensitivity analysis of the macroeconomic scenario; b) to develop, based on the sensitivity analysis, a back-up plan for the realistic case of budget revenues falling short of the estimates.
13		Regarding medium and long term development, structural reforms in order to boost potential GDP growth should be implemented, addressing the issues of a decreasing labour force, a rigid investment sector and the mismatch of the economically active population’s skills and abilities with the labour market's requirements.
14	**3 Numerical fiscal conditionality assessment**	The Council recommends to treat the allocation for the FSR as an activity related to the determination of the numerical fiscal targets and to determine the expenditure ceilings starting from 2017 including the allocation for FSR.
15		The MoF should develop a procedure for ex post of the structural balance and correction mechanism, preferably in consultation with the Council.